SOCIETY OF ACTUARIES

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Letters to the Editor

We appreciate the article by Wes Edwards that helps to advance actuarial thinking regarding the Long-Term Health Care Resource Model (Model). We share Professor Tom Getzen's view that while we cannot predict what part of GDP might shrink to accommodate a greater share allocated to health care costs in the long-term future, such a shift in resources is certainly a realistic assumption that reasonable actuaries can make.

We are somewhat puzzled by Mr. Edwards' conclusion that since under one set of input assumptions the Model produces a long-term percentage of GDP allocated to health care that is much higher than he believes to be reasonable, then the Model itself is of little or no value.

In fact, Mr. Edwards' criticism points to what is arguably the greatest strength of the Model: by forcing actuaries to document the building blocks used to develop long-term medical trend assumptions, it helps generate the kind of healthy debate initiated by Mr. Edwards.

If a plan sponsor meets with a panel of economists and futurists and they conclude that the percentage of GDP could never exceed 20 percent, because of global energy shortages, terrorism, climate change etc., then we believe the Model is sufficiently flexible to meet the needs of the plan sponsor. For example, we changed the Baseline assumptions for three of the Model inputs to reduce the ultimate percent of GDP spent on health care from 34 to 20 percent of GDP. The current percentage of GDP that goes to health care is 16.5 percent. The table compares the Baseline assumptions to the alternative scenario that we labeled "pessimistic."

We would not recommend this type of assumption setting without a thorough reading of the supporting documentation and an understanding of how the assumptions interact but it is possible to do so.

We think there may be a misunderstanding of what the Model is intended to do.

The Model forces users of the model (including the plan sponsor and auditors) to think about the underlying economic assumptions behind the long-term health care trend assumption.

The reason Baseline assumptions are provided is because the Project Oversight Group (POG) believe that the typical actuary would need guidance as to how select the assumptions, and as to what economists believe are reasonable assumptions. Accordingly we asked Professor Getzen to document how he arrived at his range and Baseline assumptions. This document is posted on the SOA Web page, and should be read carefully by users and others who explore the model results.

The Baseline assumptions are provided as a resource for actuaries who do not have the time (and budget) to work closely with economists and futurists when doing first time OPEB valuations for City X or County Y with a limited budget, and by actuaries doing FAS 106 and VEBA valuations for private sector clients who may want to use a more rigorous assumption setting process than was perhaps used in prior valuations.

Alternatively, the model input assumptions can be changed. If a user does so, it is our belief that the user should be prepared to explain why the alternate set of economic assumptions is reasonable. The July 2008 issue of the Watson Wyatt Insider has an excellent article on the Model with four alternative sets of economic assumptions, and the reasoning behind each set of assumptions.

The POG encourages actuaries to use the Model to set their assumptions and to disclose the Model inputs. Two sample disclosures are provided on the SOA Web page that were drafted by the POG, one using the Baseline assumptions and a second varying those assumptions. We believe if the user varies the baseline input values, the rationale for the change should be disclosed in the actuarial report.

Before the Model was released there was no generally accepted resource for actuaries to use to set these assumptions. Medical trend assumptions were set using a variety of methods that were not particularly transparent, and as Mr. Edwards points out one result of this lack of transparency was that trend assumptions had arguably begun to become somewhat optimistic when compared to actual experience over the past decade.

Yes, the Model is simple. That is partly because our goal was to make a model that was transparent and usable. In addition, the POG's hope is that the current model will be periodically reviewed against actual experience and improved over time as more practitioners join Mr. Edwards in probing the underlying model process.

To summarize we believe that the Model

- Is a considerable improvement over the previous methods used by actuaries to determine long-term medical trend,
- Makes available to actuaries one of many possible well thought out set of reasonable Baseline assumptions (with documentation),
- Provides flexibility to allow actuaries to use other sets of economic assumptions, and
- Is just the first step in producing tools actuaries can use to set long-term medical trend assumptions.

We encourage further critical examination of the model so that constructive improvements can be made. Ultimately, the hope of the POG that developed this initial model is that within a couple of years, a new POG can be convened by volunteers who will move the state of the model to the next level, whatever that turns out to be.

Kevin Binder, John Cookson, Russell Weatherholtz, Keith Williams, Adam Reese and Marilyn Oliver—The authors are members of the long-term medical trend POG. ■

Response

The POG members' response to my piece on the Getzen model asserts I suggested "the Model itself is of little or no value." Nothing could be further from the truth. I stated I welcome the study and I believe the model is a valuable starting point. The sole point of my article was to highlight areas, especially the need to expand beyond any potential implication of an authoritative "baseline" assumption set, and to encourage individual actuaries to go beyond the model and the accompanying assumption set; indeed I suggest as a profession we must further expand upon what the POG members concede is a simple model.

I solicited opinions from economists with think tanks (e.g., National Heritage Foundation) and academia, but they were not so bold as the POG and Professor Getzen to express a single baseline assumption opinion. As a result, I confess I do believe the "baseline" assumptions drafted by the Professor and endorsed by the POG warrant a more thorough vetting. I am not familiar with the Watson Wyatt Insider or the article referenced by the POG members, but I am confident the actuarial community would welcome the wider publication of alternative macroeconomic assumption sets.

—Wes Edwards

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Dear Editor,
I enjoyed reading the article from Mr. John Ahrens in the last HealthWatch newsletter. I would like to comment on each "myth" in Mr. Ahren's article.

Myth 1

Financial strength ratings do matter. What also matters is an understanding of the market and the risk, which typically is strengthened by longevity in the market. The fact that clients and Errors & Omissions coverage writers prefer (A) rated more than (B or C) rated companies does not surprise me. A promise to pay is only as good as the one making the promise. Although arguments can be made that even (A) rated carriers face financial difficulties and fail, there is some value to the work of rating agencies. Therefore, I believe rating should have some significance along with the carrier's track record in the employer stop loss marketplace.

Myth 2

Reinsurers are key partners. I agree that issuing carriers should take more risk. It's always a better sign when you "eat what you cook." However, since this is not always the current environment in which managing underwriters operate, the quality of the reinsurer is very important, as they are the ultimate risk-taker. It is important to have individuals on staff who have significant employer stop loss expertise and experience and can provide insights into problems and opportunities that arise. A long-term horizon is best as it is with most investments. A six-month termination notice seems fair to all parties.

Myth 3

Given the amount of time, energy and thought that goes into a manual rating approach, at least in my company, rate to manual does mean something. If you use an "off the shelf" manual that fails to capture the unique features of the provider networks and case management protocols of the companies involved (TPAs and other vendors), I understand why there would be less emphasis on rate to manual. Our greatest loss ratio problems arise out of instances where the rate to manual was 80 percent, but the group's historical experience points to a fact that it should have been at 120 percent of manual! Our manual, in most instances, is a very good starting point for assessing the risk. The underwriters need to underwrite cases and be cognizant of the risk factors, particularly when an argument is to be made that we are at, below, or above manual. Given the size of the group and the expected frequency of a catastrophic claim, there should be very little experience rating of specific stop loss premiums.

Myth 4

Unfortunately, the competition rarely keeps compensation to TPAs, brokers, carriers and managing underwriters to a level as described in Mr. Ahren's article. Competition typically forces underwriters (willing to do so) to cut rates without thinking about lowering the "expense loads." Suggesting all parties reduce their fees does not make it happen. I'm with Mr. Ahrens philosophically on this point, i.e., I'd like to figure out a way to reduce expenses across all categories in this line of business. Each player is free currently to volume discount their expenses and this would be a great start. Charging for new business quotes is creative, but unpractical in a soft market in particular.

Myth 5

This is the crux of the article commentary, i.e., is employer stop loss experience credible? I think Mr. Ahrens is chasing good experience (a.k.a. attempting to "cherry pick") by analyzing expected catastrophic claim frequencies on very small groups. At the end of the day, if the group properly sets their specific deductible at a point in which claims are random and unpredictable, why should you rely on the prior experience to establish a current premium rate?

I appreciate Mr. Ahren's comments regarding the state of the market and its myths.

Mark Troutman, President, Summit Reinsurance Services, Inc. ■